SUMMARY OF COOPERATIVE CASES

Prepared
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ANTITRUST LAWS - TREBLE DAMAGE SUIT UNDER SECTION 2 OF THE SHERMAN ACT - MILK COOPERATIVE HELD LIABLE

(Metzger Dairies, Inc. v. North Texas Producers Association, Civil No. 8271, D.C.N.D. Texas, June 1963)

In a jury trial (the second, after the first jury had held for the cooperative) granted by the judge on his own motion, the defendant cooperative was held to have violated Section 2 of the Sherman Act, and was assessed damages on a trebled basis of $1,095,000.

The case arose in this manner: The North Texas Producers Association (hereafter called "North Texas"), in the fall of 1958, announced a 30 cent per gallon premium price over the minimum price under a Federal milk order in force in the Dallas market. Metzger Dairies, Inc. (hereafter called "Metzger"), refused to pay this price. North Texas, therefore, ordered the drivers picking up member milk which had been going to Metzger to deliver this milk to a designated point under control of North Texas. The drivers disobeyed these orders. North Texas then bought its own trucks and picked up this milk. After ten days, Metzger said he would pay the cooperative's price, but only on condition that the drivers who had disobeyed the cooperative's directions (these were independent contractors) would be reinstated to their former routes. The cooperative refused to do this. Metzger then went out-of-State for his purchases for some two and a half years. He then sued to recover his increased costs.

North Texas' motion for a directed verdict was denied. It contained the following defenses:

1. The evidence did not show any public injury;

2. The evidence did not establish a situation involving interstate commerce;

3. The evidence showed no restraint of interstate commerce;

4. North Texas had no monopoly in the area of commerce;

5. North Texas never refused to sell milk but only asserted its legal right to fix the price and terms of sale;

6. There is no causal connection between the damages claimed by Metzger and the alleged conduct of North Texas;

7. Plaintiff, although finally electing to stand on Section 2 of the Sherman Act, constantly prejudiced the rights and position of North Texas by referring to matters which could only relate to alleged violations of Sections 2(e) and 3 of the Clayton Act; and

8. The proof of damage was inadequate as a matter of law.

The case is being appealed to the United States Circuit Court of Appeals.

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MILK MARKETING ORDERS - LITIGATION ON ORDER NO. 16
(UPPER CHESAPEAKE BAY MARKETING AREA)

The District Court ruling holding this order invalid (see Summary, Legal Series No. 22, page 49) was reversed by the Fourth Circuit Court of Appeals on March 11, 1963 (United States v. Willow Farms Dairy, Inc., and companion cases, 315 F. 2d 828). On subsequent petition, the Court's manadate and execution of the order was stayed as to all litigants, except Mills (Howeth M. Mills and Crawford Mills, individually and as copartners, d/b/a Mills Dairy Products Co.), pending the filing and disposition of a petition for certiorari to the Supreme Court (317 F. 2d 764).

On June 17, 1963, the Supreme Court denied the petition filed by Willow Farms Dairy, Inc. (374 U.S. 832), and a motion is pending in the District Court to enforce the payment provisions in all instances.

Mills filed an independent request for certiorari which is still pending in the Supreme Court (No. 202, 1964 Term). Because of this, the payments by Mills into the Registry of the Court are to be left there until the determination of the petition for certiorari.

The Court of Appeals concluded that the District Court erred in holding the order invalid on the grounds that (1) the Secretary, in issuing the order, failed to "find," but merely "ascertained," the parity price of milk - and even then the national not the local figure - and failed to show the process of the adjustment of it to the minimum prices established by the order, (2) the referendum as to whether the order should be made effective was illegal because the Secretary's regulations were unduly restrictive with respect to eligibility of the voters, and (3) the marketing area includes certain rural counties to the detriment of certain county handlers.

The Court said that the "parity price is a consideration but, whatever the figure, it must be adjusted in the light of the price of feeds and other factors * * *. Reasonable price, not parity price, is what the Secretary must 'find.'" The Secretary's order is not procedurally faulty in any of these respects, and it has an adequate evidentiary foundation. With respect to the referendum, the Court of Appeals said that inasmuch as the statute contains no definition of the term "producer," the Secretary has the right to define the term "and to fit the qualifications of the producer-voter, according to the proposition on referendum." The milk order "dealt only with fluid milk received at, or diverted from, a pool plant as such a plant was described in the Order. All producers making such deliveries were made eligible to vote. True, the definition in the Order did by its terms exclude some farmers who produced milk for sale generally in the respective periods and in the marketing area, and so literally were within the statutory provision for a referendum. But those producers who did not deliver to pool plants in the area were not directly touched by the Order, and hence were not deprived of a substantial right by the Secretary's definition of a voter. * * * In sum, we think the Secretary did not misconstrue the Act."

With respect to the inclusion of certain rural counties in the marketing area, the Court of Appeals said that the Secretary is to "view the situation as a whole and deal with it as an entirety. In the circumstances we are not willing to say that the Secretary was clearly mistaken in his determination that appellees' marketing operations ought to be included with those handlers and producers contributing to the Baltimore market supply." A proceeding under Section 8c(15)(A) of the Act is not for the purpose of affording a de novo hearing but merely contemplates a review of the order to determine whether it is "in accordance with law."

In overruling some additional objections to the Order, the Court of Appeals said that the Secretary "must look at the area with a wide and comprehensive perspective. He has before him the entire output of milk in the area, and he must search for the best ways and means for its disposition. Aware of the annual consumption and distribution of fluid milk, he must arrange to channel the residue into outlets the most advantageous to the producer and consumer. He fashions his order accordingly. Of course, there may be some resultant damage to a handler or producer in the enforcement of the Act but this lack of perfection does not destroy the validity of the Order. * * * Absolute equality is not demanded to sustain the operation of the Order."

In order to enforce the order against two Delaware dairies, a separate action was brought in the District Court. On July 1, 1963, Judge Layton of the United States District Court for the District of Delaware rendered an opinion in the case of Lewes Dairy, Inc., et al. v. Freeman, Civil Action 2353, in which he held that Federal Milk Order No. 16 is not in accordance with law to the extent that it regulates prices to be paid by handlers on milk not shipped into the defined marketing area. The Judge in his opinion held that such regulation constituted an economic trade barrier and cited the Supreme Court's opinion in the Lehigh Valley case, dealing with the same order, as authority for his conclusion.

Since this decision has broad implications, unless a reconsideration can be obtained with satisfactory results an appeal may be necessary.

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MILK MARKETING ORDER - AUTHORITY TO REGULATE MILK PRODUCED BY A HANDLER

The question whether the Secretary has statutory authority to regulate milk produced by a handler on his own dairy farm just the same as that which he purchases arose in Ideal Farms v. Benson. The District Court held such regulation invalid. The Third Circuit Court of Appeals reversed the District Court (288 F. 2d 608). On April 15, 1963, the Supreme Court denied certiorari (372 U.S. 965).

On June 19, 1963, the United States Court of Appeals, Fifth Circuit, agreed with the Third Circuit Court of Appeals that use of the word "purchased" in Section 8c(5)(A) and (C) of the Agricultural Adjustment Act regulating the marketing of milk does not preclude the Secretary's regulation from extending to milk produced by a handler on its dairy farm. Accordingly, in Freeman v. L. B. Vance and Ford Vance, d/b/a Vance Dairy, it reversed the decision of the District Court and sustained this feature of the Federal order for the Central Mississippi marketing area.

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FEDERAL TAXATION - INCOME TAX - APPLICATION TO CONSUMERS CREDIT RURAL ELECTRIC COOPERATIVE CORPORATION

(Consumers Credit Rural Electric Cooperative Corporation v. Commissioner of Internal Revenue, CCH 1963 Stand. Fed. Tax Rep. (63-2 U.S. Tax Cas.) par. 9583 (CA 6, July 2, 1963))

The Sixth Circuit, affirming in part and reversing in part the Tax Court (37 T.C. 136, CCH Dec. 25,105), has ruled that:

1. A cooperative organized by tax-exempt rural electric cooperative associations to finance electrical appliances and installation of electric systems for their customers is not a tax-exempt organization under Section 501(c)(12) of the 1954 Internal Revenue Code.

2. Such cooperative cannot deduct interest it paid (as an ordinary and necessary expense) on debentures that were held only by member cooperatives and provided almost all its capital, since such debentures represented equity interest rather than creditor interest; but

3. Such cooperative can deduct as patronage dividends book allocations to its member cooperatives from earnings derived from its financing operations on behalf of customers of member cooperatives, where notes evidencing purchases by such customers were transferred by dealers with recourse to the members and then transferred with recourse by the member cooperatives to such financing cooperative (the taxpayer).

The cooperative has sought a redetermination by the Tax Court of an income tax deficiency determined by the Commissioner for 1957. However, the Tax Court ruled against the cooperative on all three issues stated above. The Circuit Court sustained the Tax Court on issues one and two, but reversed on three.

Exempt Status

On this issue, the Court said the mere fact that the cooperative and its members are all organized under the same cooperative statute, does not make them all exempt. The distribution of electric energy to rural areas qualified the members as "like organizations" to mutual or irrigation companies or mutual or cooperative telephone companies within the meaning of Section 501(c)(12). The Court did not consider "financing consumer purchases" a "like" operation.

Interest v. Dividends

On the second issue, the Appeals Court commented in part as follows:

"In making its ruling, the Tax Court pointed out that /taxpayer-cooperative's/ financial business required the use of capital and, in fact, capital was its sole income producing asset. All of this capital, with the exception of an infinitesimal amount paid as membership fees ($140.00 in 1957), came from the issuance of the 'debentures' and from bank loans, to which the 'debentures' were subordinated. The 'debentures' were easily the more important of the two sources and the Tax Court found as a fact that although the 'debenture' holders had the right to enforce payment of the principal upon maturity, such enforcement would seriously cripple the /taxpayer's/ financing operations. It was also pointed out that there was a close identity between the 'debenture' holders and the member rural electric cooperatives.

"Although the 'debentures' in form contained an unconditional promise to pay at a specified date with interest at a specified rate, we think it was a permissible finding on the part of the Tax Court to place reliance upon substance rather than upon form and to conclude that under all the circumstances in the case neither the taxpayer nor its member cooperative associations intended such advances to create a bona fide debtor-creditor relationship. Wilbur Security Co. v. Commissioner, 279 F. 2d 657, C.A. 9th, affirming 31 T.C. 938."

Patronage Dividends

In reversing the Tax Court on this issue, the Appeals Court said:

"True patronage dividends are restricted to rebates or refunds on business transactions with its members. Any profits made on business transacted with nonmembers, which may be distributed to members are fully taxable. Pomeroy Cooperative Grain Co. v. Commissioner, 31 T.C. 674, affirmed on this issue 288 F. 2d 326, 331, C.A. 8th. See Farmers Cooperative Co. v. Birmingham, 86 F. Supp. 201, 212-213, 217-225, 235-238, N.D. Iowa.

"The Tax Court ruled against the /taxpayer/ on this issue because in its opinion the patronage dividend allocated on its books to its member cooperatives represented a net

profit from transactions with purchasers from appliance dealers rather than from transactions with member cooperatives, and that the member cooperative was nothing more than a conduit in carrying out the transaction.

"We are of the opinion that this ruling fails to take into consideration the fact that the note executed by the purchaser of an appliance from a dealer was transferred by the dealer to the member cooperative with recourse, before the /taxpayer/ became a party in the transaction and that the member cooperative thereafter transferred the note to the petitioner with recourse. /Taxpayer's/ transaction was with the member cooperative, from whom it purchased the note, not with the nonmember purchaser or dealer. If the maker of the note defaulted there was a liability on the part of the member cooperative to the /taxpayer/, which it might or might not be able to recoup from the dealer, with litigation to enforce its rights a possibility. We think this made the member cooperative more than a mere conduit and that the purchase of the note from the member cooperative was a separate transaction between the /taxpayer/ and its member cooperative within the meaning of the rule."

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FEDERAL TAXATION - ORDINARY AND NECESSARY EXPENSES

(<u>Anaheim Union Water Company, Petitioner</u> v. <u>Commissioner of Internal Revenue, Respondent</u>. <u>Santa Ana River Development Company, Petitioner</u> v. <u>Commissioner of Internal Revenue, Respondent</u>. CCH 1963 Stand. Fed. Tax. Rep. (63-2 U.S. Tax Cas.) par. 9589 (CA 9, July 2, 1963))

The Ninth Circuit has reversed the Tax Court in part and sustained it in part in the cited cases. The Tax Court decision was reported in Summary, Legal Series No. 19, page 58.

By the reversal, the Court has allowed a mutual nonprofit irrigation company to deduct as ordinary and necessary business expenses the cost of furnishing water to its shareholders, even though the costs exceeded the amounts received from the sale of water to shareholders, and the company used rental and royalty income to reduce such costs. The ruling pivoted on the fact that the company was required to supply its shareholders with water at cost and without profit and that its bylaws required it to use all of its income to accomplish the furnishing of water.

In addition, the Court allowed a water service company, which had been organized by two mutual nonprofit irrigation companies to protect their water rights, to apply rental income against the part of its expenses which exceeded amounts received from its two shareholders for furnishing water services.

The Commissioner, who had been upheld by the Tax Court, argued that the portion of the mutual irrigation company's expenditures which exceeded its receipts from the sale of water to shareholders should be disallowed because ordinarily when a business makes expenditures for the production of a product, it is intended that the business will recover the whole amount of its costs through the sale of the product. The Court agreed that this reasoning would generally apply in cases of companies carrying on business for profit but that if the irrigation company fixed its prices for water at a figure which would return all its water costs, its incidental income (rents and royalties) would then be accumulated as profits and the company would be operated contrary to the provisions of its articles of incorporation.

The argument concerning the water service company, which had been formed by two mutual irrigation companies to protect their water rights, centered on the fact that the water service company held record title to lands conveyed to it by the two irrigation companies and that it applied the income therefrom to its expenses. However, since the grantors had conveyed the lands and reserved to themselves the benefit of any income which might be derived therefrom, the Court found that there was nothing extraordinary in the water service company's making or carrying out this obligation. Therefore, all expenditures for water service were ordinary and necessary, notwithstanding they were recouped through the application of rentals received from the lands of record, plus direct payments from the two mutual nonprofit irrigation companies.

The principles developed in these cases would seem to lend support to the conclusions reached by the United States District Court in Mississippi Chemical Corporation v. United States (see Summary, Legal Series No. 18, page 39). There it was held that a taxable farmer cooperative could by charter provide for common stock dividends to be paid first from margins of non-member business. The Tax Court was sustained only in its ruling that the Commissioner was correct in requiring an allocation of income and deductions between the two mutual irrigation companies and a water service company which they jointly owned and with which they were cotenants of land. This was required even though the service company received all the rent and paid all the expenses.

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TRANSPORTATION - LEASING EQUIPMENT IN PRIVATE CARRIAGE - SOME ARRANGEMENTS VALID DESPITE DRUM CASE

(Lloyd G. Swift and Massey-Ferguson, Inc., I.C.C. Docket MC-C-2634, June 28, 1963)

The "test of substance," established by the Supreme Court in the *Drum* case does not proscribe all use of leased vehicles by shippers in private carriage. The Interstate Commerce Commission made this clear when it issued a "short form order" sustaining the findings of the hearing examiner in the instant case.

The Interstate Commerce Commission Bureau of Inquiry and Compliance had contended that the drivers in this proceeding were under the same degree of control and supervision by both Swift and Massey, as were the owner-operators in the *Drum* case, and that Massey gets motor equipment fully serviced plus furnished and selected drivers.

The Interstate Commerce Commission did not agree, could reach no conclusion that Swift had any effective control over the drivers or over the operation of the equipment utilized by Massey. It concludes, instead, that the drivers are bona fide full-time employees of Massey and that their position as such is not lessened by the connections, past and present, with Swift. Further, the Interstate Commerce Commission notes, the evidence establishes that Massey has exclusive use of the leased equipment and full control over its use and movement in the transportation of Massey property.

Swift, a dealer in agricultural instruments at Carrollton, Missouri, owned three tractors, three trailers, and one straight truck. He had leased the three tractors and trailers to Massey since 1955.

According to the examiner:

> "The current lease covers a period of one year, and thereafter from year to year, provided either party may terminate all or part of the agreement at any time upon 90-days written notice to the other party. Payment for the use of the vehicles is to be computed at the rate of 25 cents per running mile for each tractor-trailer combination, payable monthly, with a yearly guaranty of $37,500[1]. Under the lease, Massey agrees,

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"1. Swift's gross income in 1961 from leasing vehicles to Massey, computed in the manner hereinafter indicated, was $52,491.74.

among other things, to employ only experienced and careful drivers to operate the vehicles, who shall qualify to meet any requirement imposed by federal, state, or municipal regulatory agencies or the carrier of insurance with respect to the vehicles and to pay or provide (1) all taxes and assessments that may be levied on the vehicle in respect to the use and operation thereof; (2) all toll charges, including tunnel, bridge, ferry, and federal, state, and local highway fees in respect to the operation and use of the vehicles; (3) premiums for cargo insurance on every load of merchandise carried in the vehicle during the term of the lease; (4) insurance for the benefit of the lessee and the lessor against liability for bodily injury and property damage; and (5) all of the items and services necessary for the operation of the vehicle unless specifically described in the lease as being the responsibility of the lessor.

"Swift agrees to pay for the lettering, painting, and decorating of the vehicle; fuel and oil in route necessary for the operation of the vehicle; washing, polishing, and cleaning vehicle; license and tag fees for the States enumerated above; equipment necessary for the operation of the vehicle, including safety equipment; and fire and theft insurance for the full value of the vehicle and collision insurance. In addition, Swift agrees to repair and maintain the vehicle in good operating condition, to make all repairs promptly upon delivery of the vehicle to the repair shop or garage designated by it, and to furnish, at its expense, a substitute vehicle of equal capacity within a reasonable time, for any vehicle permanently out of service."

The examiner draws these basic distinctions between the facts in this case and the facts in Drum:

"In the instant case, Swift assigns his vehicles for a continuing period of time to the exclusive use of the company, Massey. He owns, furnishes, and maintains the equipment. He guarantees a fixed and definite cost for the availability and use of such equipment, bears the risk of loss from transportation hazards such as breakdown, and meets the costs of operation and trip expenses (except licenses and toll, road, and bridge charges). He maintains collision, fire, and theft insurance on the equipment; but does not furnish cargo insurance and property loss and public liability insurance, which are funished by Massey. The

primary difference between the facts in the Drum case and the instant case are (1) that the lessors in the Drum case were owner-operators, and as such could, as owners of the equipment, cancel their respective leases, on 30 days' notice, for reasons other than those connected with the lease covering the equipment, (such as dissatisfaction, as drivers, with their compensation or operating conditions), whereas here there is no such connection between the lessor of the equipment, and the driver thereof; and (2) in the Drum case the owners, as lessors, were not guaranteed any minimum mileage or minimum compensation for a particular period, while here Massey guarantees Swift an annual revenue of $37,500 a year."

And, again, in summary:

"Considering all of the facts in the instant case, including the guaranteed compensation for use of the leased equipment, the separate relationship between Swift and the drivers, the employer-employee relationship between Massey and the drivers, and the full control of Massey of the drivers and of the use and routing of the leased equipment, the examiner concludes that the facts in the instant case differ from those in the Drum case; that the substance of the total operation here, as now being performed, establishes that such operation is bona fide private carriage for which no authority is required under the certificate and permit requirements of the Act; that, therefore, Swift and Massey, neither individually nor collectively, are engaged in motor carrier operations in violation of the certificate or permit requirements of the Act; and that the complaint should be dismissed."

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TRANSPORTATION - HANDLING OF "GRANDFATHER" CASES UNDER 1958 TRANSPORTATION ACT

(Jarman v. United States and Interstate Commerce Commission, ___ F. Supp. ___, Civil No. 13692, D. Md., July 1963)

The findings and conclusions of the Interstate Commerce Commission were set aside by a three judge court in this case. The Commission, in the court's judgment, had not been liberal enough in granting "grandfather" rights for the trucking of formerly exempt commodities which became subject to regulation under the 1958 Act. The court said the Commission must adhere to the principles enunciated by the Supreme Court to govern grants of "grandfather" rights under the 1935 Motor Carrier Act. The detailed analysis by the court of the situations in which the Commission erred in its application of the statutary and decisional law to the facts established by the hearing record may be helpful to other carriers, including cooperatives, which have a similar problem.

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